

Message Text

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ACTION EB-08

INFO OCT-01 ARA-10 ISO-00 AID-05 CIAE-00 COME-00
FRB-03 INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02
OPIC-03 SP-02 LAB-04 SIL-01 OMB-01 H-01 STR-07
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R 011510Z JUN 78
FM AMEMBASSY KINGSTON
TO SECSTATE WASHDC 1512
INFO AMEMBASSY BRIDGETOWN
AMEMBASSY CARACAS
AMEMBASSY GEORGETOWN
AMEMBASSY NASSAU
AMEMBASSY PORT OF SPAIN

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E.O. 11652: N/A
TAGS: ECON, EFIN, JM
SUBJECT: INTERVIEW WITH IMF REPRESENTATIVE EWART WILLIAMS ON
IMF-GOJ AGREEMENT

REF: A. KINGSTON 3945; B. KINGSTON 4189; C. KINGSTON A-27

1. BEGIN SUMMARY: MR. EWART WILLIAMS, IMF REPRESENTATIVE,
STATED TO EMBASSY OFFICERS THAT DISCUSSIONS ARE STILL UNDER
WAY BETWEEN THE GOVERNMENT AND THE PRIVATE SECTOR WITH
REGARD TO THE TAX PACKAGE THAT THE PRIVATE SECTOR IS
ATTEMPTING TO MODIFY, BUT WHICH THE IMF VIEWS AS AN
ESSENTIAL INTEGRAL PART OF THE AGREEMENT. WITHOUT
INCLUSION OF A PACKAGE OF TAX MEASURES YIELDING AN ADDITIONAL
J\$180 MILLION THIS FISCAL YEAR, THE AGREEMENT CANNOT BE SUBMITTED
FOR APPROVAL TO THE IBRD BOARD. OTHER POINTS DISCUSSED
WITH THE IMF REPRESENTATIVE INCLUDE THE DANGER THAT THE
GOVERNMENT'S PROGRAM (WHICH ANTICIPATES A 30 PERCENT
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PRICE INCREASE IN 1978) MIGHT SET OFF AN UNCONTROLLABLE
WAGE-PRICE SPIRAL; THE RATIONALE FOR REJECTING A WAGE-
PRICE FREEZE AS AN ALTERNATIVE TO THE "INFLATIONARY
MODEL" ADOPTED; AND THE MEASURES ADOPTED BY THE
GOVERNMENT TO REGAIN THE CONFIDENCE OF THE PRIVATE
SECTOR. END SUMMARY

2. EMBASSY-AID ECONOMIC OFFICERS CALLED ON IMF REPRESENTATIVE EWART WILLIAMS ON MAY 30 TO DISCUSS A NUMBER OF QUESTIONS ON THE GOJ-IMF AGREEMENT. QUESTIONS RAISED RELATE TO THE DANGER OF SETTING OFF A WAGE-PRICE SPIRAL; THE REASONS FOR DISCARDING A WAGE-PRICE FREEZE COUPLED WITH A SMALLER TAX PACKAGE AND A SMALLER DEGREE OF DEVALUATION AS AN ALTERNATIVE TO THE HARSH TERMS OF THE PACKAGE; AND THE IMPACT OF THE GOVERNMENT'S PROGRAM ON INVESTMENT AND GROWTH.

3. MR. WILLIAMS' MAIN POINTS WERE AS FOLLOWS:

A. THE GOJ-IMF AGREEMENT CANNOT BE CONSIDERED AS HAVING PASSED ALL THE HURDLES. THE PRIVATE SECTOR IS PROTESTING VEHEMENTLY THE TEN PERCENT STAMP DUTY ON IMPORTED RAW MATERIALS. DISCUSSIONS ARE UNDER WAY AND NO FINAL DECISION HAS BEEN TAKEN. YET, A TAX PACKAGE YIELDING AN ADDITIONAL J\$180 MILLION THIS FISCAL YEAR IS AN INTEGRAL PART OF THE IMF AGREEMENT. IT CANNOT BE SUBMITTED TO THE IMF BOARD IF THE TAX COLLECTION GOAL CANNOT BE MET.

B. THE GOVERNMENT'S ECONOMIC PROGRAM IS NOT A STABILIZATION PROGRAM. THE NECESSARY CUT IN CONSUMPTION COULD BE ACCOMPLISHED EITHER THROUGH A WAGE-PRICE FREEZE ALONG WITH HIGHER TAXES AND DEVALUATION; OR BY ADOPTING LIMITED OFFICIAL USE

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THE "INFLATIONARY MODEL" WHICH WOULD INVOLVE, IN ADDITION TO HIGHER TAXES AND DEVALUATION, AN INCREASE IN PRICES GREATER THAN THE INCREASE IN WAGES. THE IMF LEFT THE CHOICE TO THE GOVERNMENT.

C. THE GOVERNMENT OPTED FOR "THE INFLATIONARY MODEL" AFTER CONSULTATION WITH UNION LEADERS. APPARENTLY, THE UNION LEADERSHIP FELT THAT A WAGE FREEZE WOULD DISCREDIT THEM COMPLETELY AND WAS THEREFORE UNACCEPTABLE. THE ALTERNATIVE CHOSEN WAS THE ONLY ONE THAT THE GOVERNMENT FELT IT COULD GET THE PEOPLE TO ACCEPT. THE NEGOTIATIONS WERE SO PROLONGED BECAUSE THE GOVERNMENT HAD TO CONVINCE ITSELF THAT IT COULD CARRY OUT THE TERMS OF THE AGREEMENT.

D. ANOTHER FACTOR WHICH LED TO THE SELECTION OF THE INFLATIONARY MODEL WAS THE NECESSITY TO CONTINUE TO FINANCE PART OF THE FISCAL GAP THROUGH CREDIT FROM THE DOMESTIC BANKING SYSTEM. MR. WILLIAMS INDICATED THAT THE UNFINANCED RESOURCE GAP WAS IN THE RANGE OF J\$450 TO J\$500 MILLION, TO BE FINANCED ROUGHLY AS FOLLOWS:
TAX PACKAGE - J\$180 MILLION
DOMESTIC COMMERCIAL BANKING

SYSTEM - 180 MILLION
FOREIGN SPECIAL ASSISTANCE
(FOREIGN COMMERCIAL BANK - 60 MILLION
LOANS CONTINGENT ON IMF
AGREEMENT)
DEBT FINANCING (BY
FOREIGN COMMERCIAL BANKS) - 70 MILLION
TOTAL - J\$490 MILLION

E. THUS, SOME J\$180 MILLION WILL STILL HAVE TO
BE PUMPED INTO THE MONETARY SYSTEM BY THE DOMESTIC COMMERCIAL
BANKING SYSTEM EVEN WITH AN IMF AGREEMENT. THIS COULD ONLY BE
AVOIDED THROUGH A CUT IN GOVERNMENT EXPENDITURES, INCLUDING
ELIMINATION OF THE EMPLOYMENT GENERATING "CRASH PROGRAM",
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WHICH THE GOVERNMENT FELT WAS POLITICALLY UNACCEPTABLE.

F. BOTH THE GOVERNMENT AND THE IMF ARE FULLY AWARE
OF THE NEED TO REGAIN THE CONFIDENCE AND OBTAIN THE
SUPPORT OF THE PRIVATE SECTOR. THE GOVERNMENT, UNDER
IMF PRODDING, HAS COME A LONG WAY TOWARD MAKING
SIGNIFICANT CONCESSIONS IN THE AREA OF RELAXING CONTROLS
AND OF GENERALLY ADOPTING MEASURES THAT THE PRIVATE
SECTOR SHOULD VIEW AS ENCOURAGING. ITEMS:

(I) RECOGNITION OF THE PRINCIPLE THAT PRIVATE
BUSINESSES ARE ENTITLED TO EARN A 20 PERCENT
ANNUAL RATE OF RETURN ON THE CURRENT

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REPLACEMENT VALUE OF ITS ASSETS, AND THAT
WAGE ADJUSTMENTS SHOULD NOT BE SUCH AS TO
DEPRESS THE RATE OF RETURN BELOW THAT
FIGURE.

(II) RELAXATION OF PRICE CONTROLS: AS PROVIDED IN
MINISTRY PAPER NO. 10, THE LIST OF PRICES
FIXED BY THE PRICES COMMISSION (LIST A) HAS
BEEN REDUCED; PRICES OF ITEMS ON LIST B CAN
BE CHANGED AFTER A THIRTY-DAY NOTICE TO
COMPENSATE FOR THE EFFECT OF THE DEVALUATION
AND THE TAX PACKAGE, THOUGH THE COMMISSION
HAS THE POWER TO ROLL BACK PRICE INCREASES
CONSIDERED EXCESSIVE; WHILE
PRICES OF ITEMS ON LIST C CAN BE RAISED WITHOUT
ADVANCE NOTICE. HOWEVER, ALL PRICE CHANGES
MUST CONFORM TO STRICT PRESCRIBED PERCENTAGE
MARGINS OR MARK-UPS.

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(III) FOREIGN INVESTORS ARE SPECIFICALLY ENTITLED
TO TAKE OUT ANY CAPITAL THAT IS BROUGHT IN
AND REGISTERED WITH THE BANK OF JAMAICA AS
WELL AS ANY REGISTERED PROFITS AND CAPITAL
GAINS.

(IV) THE STATE TRADING CORPORATION WHICH WILL
CUSHION THE RISE OF BASIC FOOD ITEMS, 1/2 DRUGS,
ESSENTIAL BUILDING MATERIALS, FERTILIZERS,
ETC. WILL NOT HAVE A MONOPOLY OVER THE
IMPORTATION OF ALL GOODS, AS PREVIOUSLY
PROVIDED IN ITS CHARTER. SPECIFICALLY,
MINISTRY PAPER NO. 10 PROVIDES THAT "IT IS
THE POLICY OF GOVERNMENT THAT OTHER IMPORTERS
MAY IMPORT ANY COMMODITY NOT ON THE STC LIST
OF ITEMS, AND THE STC WILL HONOR BONA FIDE
CONTRACTUAL LICENSING AND FRANCHISE ARRANGE-
MENTS BETWEEN IMPORTERS AND THEIR PRINCIPALS
ABROAD".

4. COMMENTS:

A. MR. WILLIAMS' COMMENTS ARE CORROBORATED BY THE GOVERNMENT'S MINISTRY PAPERS AND BY SENATOR FLETCHE (SEE REFS. B AND C). AS INDICATED IN OUR PREVIOUS COMMENTS ON THE GOJ-IMF AGREEMENT, WE VIEW THE RISKS ENTAILED BY ADOPTION OF THE "THE INFLATIONARY MODEL" AS HIGH OWING TO THE STRENGTH OF THE LABOR UNIONS, THEIR OFT-REPEATED ASSERTION THAT THEY WILL NOT ABIDE BY THE GOVERNMENT'S WAGE GUIDELINES AND THE LIKELIHOOD THAT THE UNION MEMBERSHIP WILL NOT BE FOOLED BY THE "MONEY ILLUSION". STILL, IT IS DIFFICULT TO CHALLENGE THE GOVERNMENT'S ASSERTION THAT A WAGE-PRICE LIMITED OFFICIAL USE

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FREEZE HAD TO BE RULED OUT AS A POLITICALLY UNACCEPTABLE ALTERNATIVE.

B. IT APPEARS THAT THE GOVERNMENT HAS REVERSED COURSE IN ITS POLICY TOWARD THE PRIVATE SECTOR. THE PACKAGE OF MEASURES INCORPORATED IN THE VARIOUS MINISTRY PAPERS (FORWARDED TO WASHINGTON UNDER COVER OF AIRGRAM A-25) SHOWS THAT THE GOVERNMENT IS NOW FULLY CONVINCED OF THE IMPORTANCE OF RESTORING PRIVATE SECTOR CONFIDENCE AND HAS RESOLVED TO TAKE CONCRETE STEPS TO CHANGE THE PRIVATE SECTOR'S ATTITUDE. HOPEFULLY, THIS WILL LEAD TO SOME INCREASE IN PRODUCTION, ESPECIALLY IN AREAS WITH A GOOD EXPORT POTENTIAL AND SUBSTANTIAL UNUSED PLANT CAPACITY. IT IS UNLIKELY, HOWEVER, THAT PRIVATE INVESTMENT SPENDING WILL PICK UP SIGNIFICANTLY OVER THE NEXT YEAR OR TWO. IN THE FORESEEABLE FUTURE, A NUMBER OF FACTORS ARE LIKELY TO DIM THE INVESTMENT OUTLOOK, INCLUDING UNCERTAINTIES WITH RESPECT TO A POSSIBLE WAGE-PRICE SPRIAL, THE DIFFICULT LABOR SITUATION, THE DEPRESSING EFFECT OF THE DEVALUATION AND TAX MEASURES ON PRIVATE CONSUMPTION, AND THE NEED TO RETAIN CONTROL OVER IMPORT LICENSES AND FOREIGN EXCHANGE TRANSACTIONS FOR AN INDEFINITE PERIOD.
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